REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE THABA CHWEU LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Thaba Chweu Local Municipality, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report as set out on pages xx to xx.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Accumulated deficit

4. A disclaimer of opinion was issued on the prior year's financial statements. I was unable to determine the extent of the effect of these limitations on the statement of financial position balances at 30 June 2012, and the results for the year then ended.

Trade and other receivables

5. I was unable to obtain sufficient appropriate audit evidence for parked debtors amounting to R82 501 558, as disclosed in note 2 to the financial statements. The municipality has provided for this amount as doubtful in full. I was unable to perform alternative procedures. Consequently, I was unable to confirm the valuation of parked debtors.

6. A council resolution was taken during the financial year to write off bad debts to the amount of R3 430 060, but the municipality did not recognise bad debts in the statement of financial performance. Consequently, the amount for bad debt is understated by R3 430 060 and trade and other receivables are overstated by R3 430 060.

7. A disclaimer of opinion was issued on the prior year's financial statements. I was unable to determine the extent of the effect of these limitations on the statement of financial position balances at 30 June 2012, and the results for the year then ended.

Other current financial assets

8. I was unable to obtain sufficient appropriate audit evidence for other current financial assets amounting to R12 197 150, as disclosed in note 4 to the financial statements. I was unable to confirm the disclosed figure by alternative procedures. Consequently, I was unable to confirm the completeness, existence, rights and valuation of other current financial assets.

9. A disclaimer of opinion was issued on the prior year's financial statements. I was unable to determine the extent of the effect of these limitations on the statement of financial position balances at 30 June 2012, and the results for the year then ended.

Property, plant and equipment

10. The municipality could not provide sufficient appropriate audit evidence to support the adjustments made to infrastructure assets amounting to R6 414 102, included in the fixed asset register and the financial statements. The municipality's records did not permit the application of alternative procedures.

11. I was unable to obtain sufficient appropriate audit evidence for the disposal of other movable assets with a carrying value of R6 240 764. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to confirm the occurrence, accuracy and completeness of the disposal disclosed in note 7 to the financial statements.

12. I was unable to verify the existence of property, plant and equipment amounting to R1 356 684. The municipality's records did not permit the application of alternative procedures. Consequently, I could not obtain sufficient appropriate audit evidence to confirm the existence of the closing balance of property, plant and equipment amounting to R961 520 267 (2011: R1 603 120 976), as disclosed in note 28 to the financial statements.

13. The municipality did not comply with GRAP 3, as they did not account for the change in accounting policy by adjusting the financial statements retrospectively. The misstatement resulting from the non-compliance could not be determined, as the municipality's records did not permit the application of alternative procedures. Consequently, I could not determine the effect of the adjustments.

14. In terms of Directive 7 of the Accounting Standards Board, the municipality may determine the deemed cost for the assets acquired prior to March 2009. The municipality determined the deemed costs for all assets, including those purchased after March 2009. Consequently, property, plant and equipment amounting to R961 520 267 (2011: R1 604 120 976), as disclosed in note 7 to the financial statements, is misstated. I was unable to obtain the necessary information as to the valuation of the disclosed property, plant and equipment. The municipality's records did not permit the application of alternative procedures.

Investment property

15. I was unable to obtain sufficient appropriate audit evidence for investment property amounting to R149 388 200, as disclosed in note 35 to the financial statements. Consequently, I was unable to determine the completeness, valuation, right and existence of investment property. The municipality's records did not permit the application of alternative procedures.

Trade and other payables

16. The municipality did not recognise a liability for agency fees to be paid over to the Department of Public Works, Roads and Transport. Consequently, trade and other payables are understated by R11 589 372 and income from agency fees is overstated by R11 589 372.

Creditors' unallocated deposit

17. I was unable to obtain sufficient appropriate audit evidence for creditors' unallocated deposits amounting to R9 854 158, as presented in the statement of financial position. Consequently, I was unable to confirm the completeness, obligation, existence and valuation of the creditors' unallocated deposit. The municipality's records did not permit the application of alternative procedures.

Provision for leave

18. The municipality's records for the provision for leave were inaccurate, as employees who were no longer in the service of the municipality appeared on the list and the provision was for days in excess of 48 days, contrary to the requirements of the South Africa Local Bargaining Council. Therefore, I could not confirm the accuracy of the amount stated at R6 994 448 in note 12 to the financial statements.

Revenue

19. Section 125(2)(d)(i) of the MFMA states that the notes to the annual financial statements of a municipality must disclose particulars of any material losses. The municipality did not disclose distribution losses with regard to water and electricity due to inadequate control measures to reliably calculate these losses. I was unable to determine the total extent of the understatement of distribution losses, as sufficient appropriate audit evidence could not be obtained. There were no alternative audit procedures that I could perform to obtain reasonable assurance that material losses had been properly recorded.

20. The municipality did not accrue invoices for water and electricity billed to consumers for June 2012. Consequently, I was unable to determine the completeness and accuracy of water and electricity sales amounting to R97 962 521, as disclosed in note 16 to the financial statements.

21. The municipality did not provide sufficient appropriate audit evidence to support revenue from prepaid electricity included in the amount of R73 607 954.The amount of prepaid electricity was also not proportionately split to show the portion not yet used at year-end. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to determine the accuracy and completeness of the sale of electricity amounting to R73 607 954, as disclosed in note 16 to the financial statements.

Government grants and subsidies

22. The municipality is required to recognise revenue from conditional grants when conditions are met. The municipality recognised revenue amounting to R11 009 582 before conditions were met. Therefore, government grants and subsidies, as disclosed in note 20 to the financial statements, are overstated by R11 009 582 and unspent conditional grants are understated by R11 009 582.

Employee related costs

23. I was unable to obtain sufficient appropriate audit evidence for allowances disclosed in note 22 to the financial statements amounting to R6 364 413. Consequently, I was unable to confirm the occurrence and accuracy of the allowances disclosed. I was unable to perform alternative procedures.

Grants and subsidies paid

23. In terms of the framework for the preparation and presentation of financial statements, an asset is recognised in the statement of financial position when it is probable that the future economic benefits or service potential will flow to the entity and the asset has a cost or value that can be measured reliably. The municipality incurred capital expenditure in relation to the purchase of assets amounting to R32 588 098. This expenditure was accounted for under grants and subsidies paid in the statement of financial performance. Therefore, grants and subsidies paid are overstated by R32 588 098, while property, plant and equipment is understated by R32 588 098.

Provision for landfill site

24. In terms of GRAP 17, the cost of an item of property, plant and equipment includes the initial estimate of costs for rehabilitating landfill sites. The municipality disclosed the provision for the rehabilitation of the landfill site, but the debit was included in the statement of net assets instead of increasing the cost of property, plant and equipment. Therefore, property, plant and equipment is understated by R6 302 474 and the accumulated surplus is overstated by R6 302 474.

25. A disclaimer of opinion was issued on the prior year's financial statements. I was unable to determine the extent of the effect of these limitations on the statement of net assets at 30 June 2011, and the results for the year then ended.

Cash flow statement

26. I was unable to obtain appropriate audit evidence to confirm the accuracy of the non-cash adjustment of R4 058 433 included in the cashflow statement . The municipality's records did not permit the application of alternative procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of non-cash adjustments.

Commitments

27. The municipality did not disclose commitments in the notes to the financial statements, as required by GRAP 1. Unrecognised contractual commitments amounting to R42 568 557 were identified during my audit. I was unable to obtain sufficient audit evidence to confirm the completeness of unrecognised contractual commitments. The municipality's records did not permit the application of alternative procedures.

Contingent liabilities

28. I was unable to obtain sufficient appropriate audit evidence relating to contingent liabilities amounting to R32 780 520. The municipality's records did not permit the application of alternative procedures. Therefore, I could not satisfy myself as to the valuation, obligation, existence and completeness of contingent liabilities amounting to R59 811 402 as disclosed in note 33 to the financial statement.

Irregular expenditure

29. The municipality did not disclose irregular expenditure of R21 014 911 identified during the audit. Therefore, irregular expenditure, as disclosed in note 30 to the financial statements, is understated by R21 014 911.

Unauthorised expenditure

30. The municipality did not disclose unauthorised expenditure in the notes to the financial statements, as required by section 125(4)(a) of the MFMA. The municipality incurred expenditure amounting to R5 715 648 on the expanded public works programme, which was not budgeted for. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of unauthorised expenditure. The municipality's records did not permit the application of alternative procedures.

Aggregation of immaterial uncorrected misstatements

31. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the notes to the financial statements:

    - Current assets reflected as R1 180 940 387 are overstated by R616 382
    - Current liabilities reflected as R1 890 962 296 are understated by R929 273
    - Expenditure reflected as R375 314 987 is understated by R2 527 474
    - Fruitless and wasteful expenditure reflected as R3 671 415 is understated by R138 254.

Disclaimer of opinion

32. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Additional matter

33. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary information

34. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

35. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

36. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.

37. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

38. The reliability of the information in respect of the selected development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

39. The material findings are as follows:

Usefulness of information

Presentation

40. Improvement measures in the annual performance report for all planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act. This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

41. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. The following shortcomings were noted in this regard:

    - A total of 77% of the reported objectives were not consistent with the objectives as per the approved integrated development plan. This was due to a lack of a performance management system.
    - A total of 97% of the changes to objectives were not approved and 100% of the changes to indicators were not approved.
    - A total of 92% of the reported indicators were not consistent with the indicators as per the approved integrated development plan. This was due to a lack of a performance management system.
    - A total of 85% of the reported targets were not consistent with the targets as per the approved integrated development plan. This was due to a lack of a performance management system.

Measurability

42. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. All indicators relevant to the provision of basic water supply, roads and storm water, sanitation and electricity were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to a lack of a performance management system for the collection of actual performance information.

Compliance with laws and regulations

43. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Annual financial statements, performance report and annual report

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements and supporting records not provided resulted in the financial statements receiving a disclaimer of audit opinion.

45. The 2010-11 annual report was not tabled in the municipal council, as required by section 127(2) of the MFMA. A written explanation was not submitted to the council setting out the reasons for the delay in tabling the 2010-11 annual report in the council, as required by section 127(3) of the MFMA.

46. The municipality did not establish a performance management system that was in line with the priorities, objectives, indicators and targets contained in its integrated development plan; clarify the roles and responsibilities of each role player in the functioning of the 77system; determine the frequency of reporting and the lines of accountability for performance; and provide for procedures to link the system to the municipality's integrated development planning processes, as required by section 38(a) of the MSA and Municipal Planning and Performance Management Regulation 7(2)(c), (e), (f) and (g). Consequently, the municipality could not monitor and review its performance management system, as required by section 40 of the MSA.

47. The annual performance report for the year under review did not include the performance of the municipality, a comparison of the performance with set targets, a comparison with the previous financial year as well as measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.

Asset and liability management

48. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.

49. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

50. Short-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of sections 45(2), of the MFMA.

Audit committee

51. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA. Furthermore, the audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.

52. The performance audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal Planning and Performance Management Regulation 14(4)(a)(ii).

Budgets

53. Unforeseeable or unavoidable expenditure not provided for in the annual budget was incurred without being appropriated in an adjustment budget, in contravention of section 29(2)(d) of the MFMA.

Conditional grants received

54. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.

55. The municipality did not evaluate its performance in respect of programmes funded by the conditional grants and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of DoRA.

56. The municipality did not timeously submit project registration forms for projects it intended implementing in the financial year under review to the Department of Local Government, as required by the Division of Revenue Grant Framework issued in *Gazette No. 34280*.

57. Allocations were utilised for purposes other than those stipulated in the Division of Revenue Grant Framework issued in *Gazette No. 34280*, in contravention of section 15(1) of DoRA.

58. The municipality did not submit MFMA implementation plans to the National Treasury to address weaknesses in financial management, as required by the Division of Revenue Grant Framework issued in *Gazette No. 34280*.

59. The municipality did not submit, within 20 days after the end of each month, its monthly expenditure reports to the Department of Cooperative Governance and Traditional Affairs, as required by the Division of Revenue Grant Framework issued in *Gazette No. 34280*.

60. The municipality did not comply with the preparations for next financial year and 2013/14 financial year as required by section 26 of the Division of Revenue Act in that the final allocations were not submitted to the National Treasury by 7 December 2011.

Expenditure management

61. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

62. The accounting officer did not take effective steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Internal audit

63. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14(1)(a).

64. The internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA, and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal Planning and Performance Management Regulation 14(1)(b)(i), (ii) and (iii).

Procurement and contract management

65. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the supply chain management (SCM) policy, in contravention of SCM Regulations 16(b) and 17(b).

66. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM Regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM Regulation 36(1).

67. Invitations for competitive bidding were not always advertised for the required minimum period, as required by SCM Regulation 22(1) and (2).

68. Bids were not always evaluated by bid evaluation committees composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM Regulation 28(2).

69. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.

70. Bids were not always evaluated and adjudicated by committees composed in accordance with SCM Regulation 28(2) and 29(2).

71. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM Regulation 29(5)(b).

72. Contracts and quotations were awarded to bidders based on preference points that had not been allocated and calculated in accordance with the requirements of the PPPFA and its regulations.

73. Contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

74. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the Construction Industry Development Board Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB Regulation 18.

75. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM Regulation 43.

76. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).

77. Awards were made to providers who are persons in the service of other state institutions or whose directors or principal shareholders are persons in the service of other state institutions, in contravention of SCM Regulation 44. Similar awards were identified in the prior year and no effective steps had been taken to prevent or combat the abuse of the SCM process in accordance with SCM Regulation 38(1).

78. The prospective providers' list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year, as per the requirements of SCM Regulation 14(1)(a)(ii) and (2).

Revenue management

79. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Internal control

80. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

81. Oversight responsibility was not exercised regarding financial and performance reporting and compliance and well as related internal controls.

82. Effective human resource management was not implemented to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.

83. Policies and procedures that enable and support the understanding and execution of internal control objectives, processes and responsibilities had not been adequately established and communicated to staff.

84. The action plan was not adequately developed and monitored to address internal deficiencies.

85. An information technology governance framework was not established to support and enable the business, deliver value and improve performance.

Financial and performance management

86. Controls over daily and monthly processing and reconciling of transactions were not implemented.

87. Management did not review and monitor compliance with laws and regulations.

88. Management did not prepare regular, accurate and complete financial and performance reports that were supported by reliable information.

Governance

89. The internal audit function did not conduct reviews of performance information systems.

90. The audit committee did not fully discharge its mandate as required by the MFMA.

AUDITOR - GENERAL

Nelspruit

30 November 2012

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence